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Backgrounder

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# Ottawa's Incredible Disappearing Act:

## *Canadians pay billions more in tax than the budget shows, and the gap is growing*

*by*

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A key message in last month's federal budget was that the government's financial strategy is not only reducing the deficit, but also bringing down the overall size and cost of the federal government. According to the budget projections, Ottawa will collect a little less than $138 billion in taxes and other revenue in the upcoming 1997/98 fiscal year. At some 16.5 percent of gross domestic product (GDP), this will be a smaller share of the economy than was typical of the 1980s. More strikingly, it is down from 18 percent back in 1991/92 — a rate of decrease that, if maintained, would see the federal government's share of the economy shrink to zero around the time today's toddlers reach retirement.

But before the prospect of a federal disappearing act raises excessive fears — or hopes — let's take a look backstage. When Statistics Canada produces its comprehensive Financial Management System tally of fiscal year 1997/98, it will likely record well over $150 billion of taxes and other revenue passing through the in-trays and computers of Revenue Canada and other federal agencies. Measured against GDP, this will be a larger share of the economy than the 1980s' average, and a much less impressive (less than one percentage point) decline from the early 1990s' peak.

In the language of everyday experience, Ottawa will collect about $20,000 per family of four in 1997/98. Even after adjusting for population growth and inflation, this will be within spitting distance of the highest years on record (see figure), and some $1,700 per family higher than the budget shows.

The missing money is tucked away in a variety of files. The bulk of it, however, can be found in two rather unpopular ones. The budget projects personal income tax revenues of $66.5 billion in the upcoming fiscal year. The much-reviled GST is shown as bringing in $17.5 billion. Yet the actual total amounts of income tax and GST that taxpayers will remit will prob-

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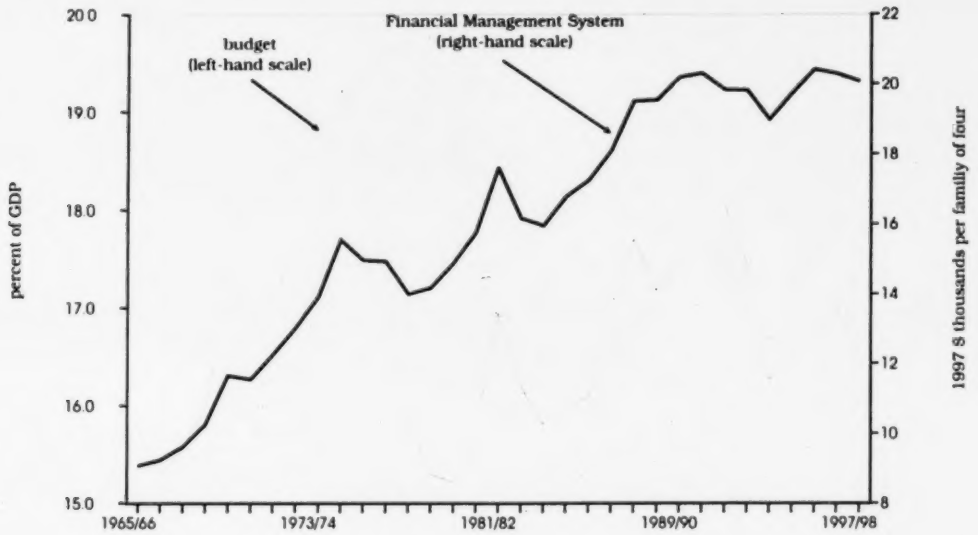
***Two Views of Federal Government Revenue, fiscal years 1965/66 to 1997/98***




ably be somewhere above $72 billion and $20.5 billion, respectively. The difference, close to $9 billion in total (around $1,200 per family), represents the Child Tax Benefit and GST tax credit — income-support programs for less well-off Canadians that are labeled as tax credits, and deducted from revenue in the public accounts.

This sort of thing is not new. For about 20 years, federal finance ministers have been finding ways to deliver transfer payments through the tax system so that, netted against revenue rather than added to spending, they would make the federal government look smaller. (Netting certain revenues, such as the Air Transportation Tax, against the expenditures of the relevant department is a variation on the theme.) Repeated use of this trick has raised the understatement of revenue and spending in the public accounts from a few hundred million dollars in the 1970s to its present-day multibillion-dollar scale. And the incredible disappearing act continues: by the end of the decade, thanks largely to the budget's promised enhancements to the Child Tax Benefit and to growth in both income tax and GST collections over time, close to $14 billion in annual revenue — and the spending that it pays for — may never appear in federal budgets.

The trick clearly works. The impression of a pronounced trend decline in Ottawa's size conveyed in the budget has become a staple of popular commentary on federal fiscal policy. Debates over the relative contributions of tax hikes and spending cuts to the deficit's decline have focused largely on baselines and shares of GDP. Amid wrangles over whether a lower-than-expected increase is a cut, or whether it is sensible to start from an assumption that Ottawa should grow in lockstep with the economy, the disguising of spending increases as tax cuts has gone all but unnoticed.

Given this record, one wonders why no one thought of delivering the $22 billion seniors benefit scheduled for implementation in 2001 as a personal income tax credit. At a stroke, the apparent burden of the personal income tax could have been cut by more than one-quarter! And why stop there? Ottawa could convert equalization payments into refundable tax credits for residents of less well-off provinces. Or it

could move the employment insurance account back off-budget, as it used to be, showing only the difference between employment insurance contributions and benefits, rather than their total amounts, in the public accounts. With a little more effort along these lines, federal budgetary revenue could be reduced almost to nothing before even the toddlers' parents retire.

The problem, of course, is that disappearing acts tend to be more show than substance. What we see is not necessarily what we get. Whether they appear in the budget or not, taxes paid to Revenue Canada still have major consequences for Canadians. They affect decisions about how, or whether, to hire or work. They pull people up out of, or push them down into, the underground economy. And they add to compliance costs and erode civil liberties as tax enforcement becomes more intrusive and technological.

Spending programs are no less important. In or out of the budget, federal transfers make a sizable difference to the living standards of those who receive them and affect people's choices about what to do — and what to tell the government about what they do. Determining eligibility for child-related and income support transfers through personal tax information is administratively efficient. But administrative convenience is no excuse for removing these transfers from the budget by netting them against taxes.

Members of Parliament and voters alike know less now about what is being spent, and on whom, than they used to. Control over public money is fundamental to parliamentary government, and that control is compromised when the budget starts telling a story very different from the reality of Ottawa's taxation and spending. It is not just dollar amounts that disappear with a wave of the pencil: transparency and accountability are doing a vanishing act as well.

Alongside high-profile budget issues such as changes to employment insurance and the tax treatment of pension savings, federal accounting practices are not big attention grabbers. But a smart audience knows where to look. A careful examination shows that Canadians pay almost 10 cents on the dollar more personal income tax, and almost 20 cents on the dollar more GST, than last month's budget showed.

It is time for another wave of the pencil that restores these hidden taxes and programs to clear view. Until then, Ottawa's incredible disappearing act will be — well, incredible.

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